FISCAL NOTE

Bill #:	SB0256	**Title:**	Revise property taxation of class eight business equipment
Primary Sponsor:	Ellingson, J	**Status:**	As Amended in Senate Committee

Sponsor signature Date Chuck Swysgood, Budget Director Date

Fiscal Summary	**FY 2004 Difference**	**FY 2005 Difference**
Expenditures:		
General Fund	$513,036	$296,488
Revenue:		
General Fund	$2,255,107	$2,255,107
State Special Revenue	$183,921	$183,921
Net Impact on General Fund Balance:	$1,742,071	$1,958,619

☒	Significant Local Gov. Impact	☒	Technical Concerns
☐	Included in the Executive Budget	☐	Significant Long-Term Impacts
☐	Dedicated Revenue Form Attached	☒	Needs to be included in HB 2

Fiscal Analysis

ASSUMPTIONS:

Revenue – Change in Class 8 Tax Rate

1. This bill exempts from property taxation the first $50,000 of class 8 business equipment for each business. The bill imposes taxable rates on class 8 property based on the market value of the business equipment where for each business: the first $50,000 in market value is exempt, the next $10,000,000 has a rate of 3%, and market value in excess of $10,050,000 ($10,000,000 + $50,000) has a taxable rate of 6%. For the first two years, any business that is new to paying property taxes on class 8 property, the tax rate is 3% regardless of the market value of the equipment.
2. The bill provides for the apportionment of the $50,000 exemption. The $50,000 exemption apportioned to each school district is equal to the ratio of the market value of all class 8 property owned by the business in the school district to the total market value of all class 8 property owned by the business.
3. The proposal does not contain an apportionment mechanism for allocating the taxable value generated by the 6% tax rate. A mechanism similar to the apportionment of the $50,000 exemption would work.
4. The bill eliminates the phase out of class 8 property.
5. The following analysis presented in the following assumptions is based on tax year 2002 data. The impact of the proposal should not vary significantly from the results below.

6. For tax year 2002, it is estimated that 29,441 businesses pay property tax on class 8 business equipment with a statewide total market value of $3,950,773,042.

Table 1
Distribution of Business by SB256 Bracket

Class 8 Tax Bracket	Tax Rate	Number of Businesses Not Exceeding Bracket	Current Law Market Value
Less than $50,000	0%	21,043	376,133,547
$50K to $10.05M	3%	8,355	1,821,325,948
More Than $10.05M	6%	43	1,753,313,547
TOTAL		29,441	3,950,773,042

7. The number of businesses with total class 8 market value less than $50,000 is estimated to be 21,043. Under SB256, these businesses would be exempt from paying class 8 property taxes.
8. The number of businesses with a total class 8 market value greater than $50,000, but less than $10,050,000, is estimated to be 8,355. These businesses would have the first $50,000 of value exempted from property tax and have a tax rate of 3% applied to the remaining market value. The amount of class 8 taxable for theses businesses under SB256 would be less than their taxable value under current law.
9. The estimated number of businesses with total class 8 market value greater than $10,050,000 is 43. These businesses would receive the $50,000 exemption, would have a tax rate of 3% applied to the next $10,000,000 in market value, then would have a tax rate of 6% applied to the market value in excess of $10,050,000. The amount of class 8 taxable value for these businesses would be more under SB256 than their taxable value under current law.
10. The amended proposal allows for an incentive tax rate reduction from 6% to 3% if the business is able to show an increase in FTE jobs of at least 2.5% from the calendar year 2 years prior to the year in which the incentive tax rate of 3% is applied. It is assumed that the intent is that the business must be able to demonstrate at least a 2.5% growth in the aggregate number of jobs in Montana. (Technical note #3)
11. The number of FTE jobs for calendar years 2001 or 2002 is not available. The Department of Revenue has counts of the number of W2 forms filed in calendar years 2000 and 2001. The number of W2 forms filed with the department will be used as a proxy to measure the increase in FTE jobs. From calendar year 2000 to calendar year 2001, 8 of the 43 companies with greater than $10,050,000 in market value of class 8 property had an increase of greater than 2.5% in the number of W2 forms filed with the Department of Revenue. It is assumed that the same number of companies will qualify for the reduced tax rate of 3% and the same amount of market value will qualify for the 3% tax rate in FY2004 and in FY2005.
12. It is estimated that the rate structure of SB256 would increase total statewide taxable value of class 8 property by $5,147,701.

Table 2
Estimated Change in Taxable Value due to SB256
(As Amended in Senate Committee)

Class 8		Taxable Value		
Tax Bracket	Tax Rate	Current Law	SB256	Difference
Less than $50,000	0%	11,284,522	0	(11,284,522)
$50K to $10.05M	3%	54,400,638	41,879,643	(12,520,995)
More than $10.05M	6%	50,884,611	79,837,829	28,953,218
TOTAL		116,569,771	121,717,472	5,147,701

13. It is estimated that an increase in taxable value of $7,050,390 is located in a Tax Increment Finance (TIF) district. An increase in taxable value in a TIF district would increase the incremental taxable value of the district. Property tax revenue generated on the increase in taxable value, with exception to the property tax paid on the university 6-mill levy, would be revenue for the TIF district.
14. The amount of net change in taxable value that for the state general fund, local governments and schools, is a *decrease* of 1,902,689 ($5,147,701 - $7,050,390). Average mill levy for the state general fund is 95.54 mills. Average mill levy for local governments and schools is 378 mills.
15. The amount of increase in net taxable value that would generate property tax revenue for the university (6-mill levy) is $5,147,701.
16. The proposal contains a mechanism to offset any increase or decrease in property tax revenue to local governments (counties and cities) and local schools due to the change in tax rates to class 8 property. This is done by adjusting the current law HB124 entitlement share payments to counties and cities, and by adjusting the HB124 block grant payments to schools (including countywide retirement and transportation). If a local government realized a net increase in taxable value, the HB124 payment to the local government would be reduced by an amount equal to the net increase in taxable value times the mill levy of the local government. Conversely, if a local government realized a net decrease in taxable value, the HB124 payment to the local government would be increased by an amount equal to the net decrease in taxable value times the mill levy of the local government.
17. To accommodate the netting out of an increase in property tax revenue and the associated decease in HB124 payment, the proposal adds language that defines the increase in class 8 taxable value, due to the rate change, as newly taxable property. This allows counties and cities to collect new property tax revenue on the increase in taxable value to offset the decrease in HB124 payment.
18. The change in property tax revenue and HB124 payments is shown in Table 3 below.

Table 3
Estimated Change in Revenue

Entity	Estimated Change in Revenue Property Tax +	HB124 Payment =	Net
State General Fund	(181,783)	na	(181,783)
State University 6-mill	30,886	na	30,886
Local Govts and Schools	(719,216)	719,216	0
TIF District	3,821,311	(298,797)	3,522,514
TOTAL	2,951,198	420,419	3,371,618

19. The state general fund would see a decrease in property tax revenue of $181,783 ($1,902,689 x .09554). The university 6-mill levy would see an increase in property tax revenue of $30,886 ($5,147,701 x .006). Overall, property tax revenues for local governments and schools would decrease $719,216. This decrease in overall property tax revenue would be offset by an overall increase in HB124 payments of $719,216. The increased HB124 payment would be reflected as an increase in state general fund expenditures. The TIF district would see an increase in property tax revenue of $3,821,311. The decrease in the HB124 payment of $298,797 to the TIF district would reduce the HB124 payment to the TIF district to $0. The change in total HB124 payments is an increase of $420,419 ($719,216 - $298,797) in FY2004. The increase in total HB124 payments in FY2005 is estimated to increase 3% above FY2004 level to $433,032 ($420,419 x 1.03).
20. The change in tax rates is effective January 1, 2003. Businesses with personal property that is not liened-to-real property pay their personal property tax in May of each year. Approximately 38% of all class 8

taxable value is not liened-to-real. Due to this, there is a property tax revenue impact in FY2003 to state, local governments, and schools. The mechanism that offsets a loss or gain in property tax revenue does not apply to a loss or gain in property tax revenue in FY2003. Overall, the net change in property tax revenue in FY2003 should be small. However, the impact to individual local governments and schools may not be small.

Revenue – Change in Taxation of Computer Software

21. SB 256 proposes to exclude computer software from the definition of intangible personal property. SB 111, passed by the 1999 legislative session, exempted from property taxation, intangible personal property including software.
22. Currently, the department's administrative rules allow for intangible personal property to be removed from centrally assessed company's market value, based on a standard industry percentage. The current law industry percentages are:

5%	Railroad Companies	(applies to property class 12)
10%	Electric Companies	(applies to property classes 5, 9, 13)
15%	Telecommunications	(applies to property classes 5, 9, 13)
10%	Airlines	(applies to property class 12)
5%	Telephone Cooperatives	(applies to classes 5, 9)
5%	Pipelines	(applies to classes 7, 9)
5%	Electric Cooperatives	(applies to classes 5, 9)

23. Under the bill, it is estimated that the standard industrial percentages for centrally assessed property will change for each industry as follows:

    5% to 2% for Railroad Companies
    10% to 5% for Electric Companies
    15% to 5% for Telecommunications
    10% to 3% for Airlines
    5% to 3% for Telephone Cooperatives
    5% to 3% for Pipelines
    5% to 2% for Electric Cooperatives

24. In tax year 2002, it is estimated that the amount of computer software in class 8 that was exempted from property taxes under current law is $7,225,510 in market value. For purposes of this fiscal note it is assumed that this property would now be taxable at a rate of 3%. The amount of taxable value that would now be taxable in class 8 is $216,765 ($7,225,510 x .03).
25. Total taxable value statewide for classes 5, 7, 8, 9,12, and 13 are estimated to increase by $21,905,900. See table on following page for increases by tax class and the estimated increase in state property tax revenue.

Table 4
Estimated Impact of Excluding Computer Software from Intangible Personal Property Exemption

Tax Class	Property	Estimated Change in Taxable Value	Estimated Change in Property Tax Revenue State General Fund	University
5	Pollution Control, Coops	1,103,899	105,467	6,623
7	Non-Centrally Assessed Public Util.	6,834	653	41
8	Business Equipment	216,765	20,710	1,301
9	Non-Elec. Gen. Prop. Of Electrical Util.	8,747,733	835,758	52,486
12	Railroad and Airline Property	1,687,852	161,257	10,127
13	Telecommunication & Electric Property	10,142,817	969,045	60,857
TOTAL		21,905,900	2,092,890	131,435

Revenue – Change in Class 12 Tax Rate

26. The tax rate for class 12 property (railroads and airlines) is a weighted average of the tax rates of class 4 commercial property, and classes 7, 8, 9, and 13 property. The tax rate for class 12 property will be impacted by the changes in market value and taxable value caused by SB256. It is estimated that the tax rate for class 12 property would increase from 4.02% to 4.33%. This is an increase in the tax rate of 7.7%. The corresponding increase of 7.7% in the taxable value of class 12 property is an increase of $3,600,000. This would increase property tax revenue for the state general fund by $344,000 and increase property tax revenue for the university system by $21,600.

Revenue – Summary of Changes

27. The table below lists the revenue changes to the state general fund and the university system.

Table 5
Estimated Change in Revenue

	Estimated Impact of SB256	
	State General Fund	University
Property Tax Levied Revenue		
Change in Class 8 Tax Rate (Table 3)	(181,783)	30,886
Remove Computer Software Exemption (Table 4)	2,092,890	131,435
Change in Class 12 Tax Rate (Assumption 26)	344,000	21,600
Subtotal Levied Revenue	2,255,107	183,921
Change in HB124 Payments (Table 3)	(420,419)	0
TOTAL	1,834,688	183,921

Expenditures

28. It is estimated that the programming required to implement the proposal would require 6 months to complete. This would not be in time to administer the class 8 property tax payments made on the class 8 property not liened to real property.
29. Information Technology (IT) estimates that 1,910 programming hours would be needed to comply with the proposal, at a cost of $138,920. One-third of the programming cost would occur in FY2003 and the remaining two-thirds would occur in FY2004. Equipment costs are estimated to cost $5,897 for fiscal 2003.
30. Total estimated one-time IT costs for FY2003 are $52,204 ($46,307 + $5,897).
31. Total estimated costs in FY2004 are $92,617.
32. It is estimated that the reduction in workload created by removing approximately 21,000 class 8 property taxpayers from the tax rolls will eliminate 5.0 FTE (grade 9). This savings will occur in FY2005. The FTE will be needed in FY2004 to implement the proposal.

FISCAL IMPACT:	FY 2004 Difference	FY 2005 Difference
FTE		(5.0)
Expenditures:		
Personal Services	$92,617	($136,544)
Local Assistance – HB124 Payments	$420,419	$433,032
Funding of Expenditures:		
General Fund	$513,036	$296,488

Revenues:		
General Fund (01)	$2,255,107	$2,255,107
State Special Revenue (02)	$183,921	$183,921
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):		
General Fund (01)	$1,742,071	$1,958,619
State Special Revenue (02)	$183,921	$183,921

EFFECT ON COUNTY OR OTHER LOCAL REVENUES OR EXPENDITURES:

1. Each local government will see either an increase or decrease in property tax revenue do to the change in taxation of class 8 property. Any increase or decrease in property tax revenue will be nullified by an offsetting adjustment to the HB124 payment. The proposal allows any increase in taxable value due to the change in rate for class 8 property to be considered newly taxable property. This allows the county or city to generate new property tax revenue to offset the planned reduction of their HB124 payment. The HB124 payment will be increased for those local governments that realize a taxable value decrease due to the tax rate change for class 8 property. Under this mechanism, local governments will receive the same combined revenue from class 8 property tax revenue and HB124 payments as under current law. This would negate the necessity for those local governments to increase mill levies to maintain current revenue levels. However, under 15-10-420, MCA, those local governments that realize a decrease in class 8 property tax revenue and receive an equal increase in HB124 payments are not prohibited from increasing mill levies to match the prior year property tax revenue level. If so, then the increase in the HB124 payment would be a windfall.
2. The increase in taxable value due to exempt property becoming taxable (computer software) is considered newly taxable property, and counties and cities are allowed to collect new property tax revenue on this new taxable value if they chose.
3. The increase in taxable value due to the change in the class 12 tax rate would not be considered newly taxable property. Mill levies calculated under 15-10-420 with this increase in taxable value will be lower than mill levies calculated under current law (without the mill levies).
4. Impact of the Class 8 Trigger - see long range impacts.

LONG-RANGE IMPACTS:

1. The proposal removes the trigger calculation that, under current law, would result in the eventual exemption from property tax for class 8 property. Under current law, if the trigger were to hit in tax year 2004 and the tax rate for class 8 property is phased down to 0%, the property tax revenue decrease for county, city, and local schools is estimated to be $5,572,377 in fiscal year 2004, $22,443,923 in fiscal year 2005, $42,237,981 in fiscal year 2006.
2. Under current law there is no replacement revenue designated to backfill the revenue loss to local governments and schools. Under 15-10-420, MCA, county and city governments could float their mill levies to offset this property tax revenue loss. The extent of revenue loss to counties and cities is dependant on each county and city government's choice to absorb the revenue loss, or to float mill levies to offset some or all of the revenue loss. If the loss in property tax revenue is to be replaced by additional property tax revenue by floating mills, it is estimated that the increase in local mill levies would average be 2.88, 11.87, and 22.92 mills for fiscal years 2004, 2005, and 2006 respectively. This is an average increase in local mill levies of 0.8%, 3.2%, and 5.9% respectively.
3. If SB256 passes and the trigger was hit, the property tax revenue losses and associated mill levy increases stated above will not occur.

<u>TECHNICAL NOTES:</u>

1. The Bill is retroactive for tax year 2003. This is problematic. It is unlikely that the programming required to apportion the $50,000 exemption could be completed by the time the property taxes paid on the non-leined to real class 8 property taxes are due in April 2003.
2. The bill contains a method of allocating the value of the exemption of the first $50,000 among the taxing jurisdictions where the business is located. Some type of allocation methodology would also be necessary for allocating the non-exempt market value. This is important with respect to the market value in excess of the $10,050,000 and the market value that is subject to local abatement of taxable value.
3. New Section 4 of the proposal could contain language that clarifies that the 2.5% increase in FTE jobs refers to a 2.5% increase in the statewide aggregate FTE jobs. Suggested language is "…If a person or business entity <u>through consideration of all its statewide aggregate properties</u> has an increase in full time equivalent jobs…."
4. A provision of SB256 is to increase the state HB124 entitlement share payment for a taxing jurisdiction if SB256 results in a decrease in taxable value. The concept is that the increased HB124 entitlement share payment would offset the loss in property tax revenue and the local government would not have to increase mill levies. However, there is no provision in SB256 that would prevent a local government from increasing mill levies to offset the loss in property tax revenues and receive the increased HB124 entitlement share payment. Such a provision could be included to amend 15-10-420, MCA to prevent this possible windfall.